The U.S. equity market reached multiple milestones in August. The S&P 500® Index and the NASDAQ Composite Index both set new all-time highs. Apple became the first publicly traded company with a market capitalization of $1 trillion. The S&P 500® Index had its highest August return in four years.

It was also reported that the S&P 500® Index reached its longest record run in the post-World War II era[1]. But is it actually the longest bull market on record? Not according to measurements by Gateway[2] and others[3]. Putting technicalities aside for a moment, observing such milestones in the equity market doesn't offer much insight for most long-term investors.

The bond market has been reaching milestones of its own. Although these don't typically receive as much attention as equity market milestones, the bond market phenomena we have observed may be far more consequential for investors. Why isn't the S&P 500® Index actually in bull market record territory? It depends on the start and end dates of the previous record period under consideration. Those who consider the current bull market the longest on record identify the start and end points of the previous record as October 11, 1990 to March 24, 2000. This implies that a bear market ended on October 11, 1990. While a significant market decline occurred in 1990, it narrowly missed the technical definition of a bear market, a decline of at least 20%.

Specifically, from July 16, 1990 to October 11, 1990, the S&P 500® Index declined 19.20% on a total return basis and 19.92% on a price-only basis. Using the 20% definition of a bear market, the bull market that began after the crash of October 1987 did not actually end until August 2000. However, we acknowledge that reasonable people can disagree on the merits of using rounding to make 1990's significant market decline meet the technical definition of a bear market.

[1] Francola, Gina. "The longest bull then and now: How financial conditions have changed." CNBC, 25 August 2018. Web. 6 September 2018.

[2] Gateway's methodology for determining the start and end dates of bull and bear market phases uses S&P 500® Index total returns (price return plus dividends reinvested) and defines bear markets as total return losses of at least 20% from peak total return values.

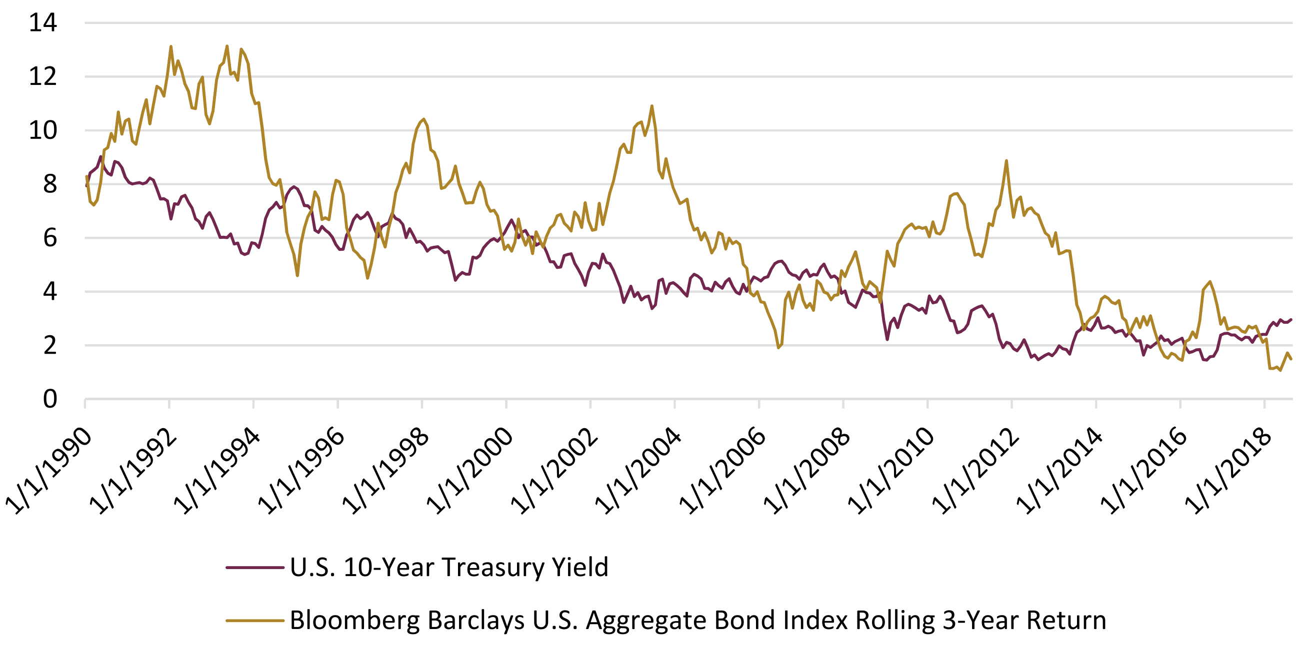
[3] "America's stockmarket passes a milestone." The Economist, 23 August 2018. Web. 6 September 2018.

Whether or not you believe the equity market is in record territory isn't ultimately very important. While Gateway believes market cycles inevitably experience both bull and bear phases, we don't think past cycles give much insight on the timing of the ebb and flow of future cycles. Unlike episodic natural forces like the tides, bull and bear markets develop from unique combinations of economic conditions and investor psychology. Whether the current bull market is the longest ever, or still years shy of the record, gives no insight as to when it will come to an end or what the next bear market will be like.

While focusing on the equity market, investors may have overlooked troublesome bond market milestones that may have a more meaningful effect on investors. With its 0.64% return in August, the Bloomberg Barclays U.S. Aggregate Bond Index (the Aggregate) has now gone 26 consecutive months with monthly returns of less than 1% (including several months with negative returns). This is an unprecedented span of sub-1% returns in the history of this bell weather bond index. As a result, the trailing three-year annualized return for the Aggregate has been stuck below 2% at the end of each month of 2018. This eight-month string of sub-2% three-year annualized returns is also unprecedented.

U.S. 10-Year Treasury Yield vs. Bloomberg Barclays U.S. Aggregate Bond Index Rolling 3-Year Returns

January 1, 1990 – August 31, 2018



Source: Bloomberg L.P. and Morningstar Direct[SM]

These mathematically-driven results have been caused by low to rising interest rates. As long as this equity bull market continues, interest rates are likely to remain low or rise and bonds will likely continue to be a drag on total portfolio return for diversified investors. This creates difficulties for investors who are exclusively using bonds to mitigate uncertainty around the timing and depth of the next bear market. Furthermore, if the virtual cap of approximately 3% for the yield on the 10-Year U.S. Treasury Note that has been in place since mid-2011 remains (i.e., if rates remain near current levels at the onset of the next bear market) any bond market rally may have limited potential to offset equity losses[4].

Because the timing of equity market cycles is so historically uncertain, we believe investors should always be prepared for the market's bull and bear phases to shift unexpectedly. Recent bond market milestones illustrate the challenges of the conventional approach of using bond market exposure to prepare for market shifts. Rather than stick with convention, investors may benefit from allocating to strategies that manage equity market risks more directly.

Low-volatility equity strategies that rely on cash flow to mitigate equity market losses and participate in equity market advances, such as those managed by Gateway, may be a suitable alternative for investors who currently favor high-quality bonds to reduce equity market risk in their portfolios. Gateway's low-volatility equity strategies strategically and consistently seek to reduce the risk of their underlying equity exposure, creating the potential to limit losses during equity market declines and to capture a majority of the long-term return of the equity market with lower risk.

[4] Bond market returns during the last two bear markets were driven in part by declines of over 2 percentage points in intermediate to long-term interest rates. If rates were to decline a similar amount from current levels during the next bear market, the resulting yields would establish new all-time lows. While this isn't an implausible scenario, the likelihood is reduced by the recent uptick in inflationary pressures. During the bear market driven by the collapse of the technology bubble, the Aggregate had a cumulative total return of 23.43% from August 31, 2000 to September 30, 2002 while the yield on the 10-Year U.S. Treasury Note (the 10-Year) declined from 5.73% to a low of 3.60% over the same period. During the financial crisis bear market, the Aggregate had a cumulative total return of 7.04% from September 30, 2007 to February 28, 2009 while the yield on the 10-Year declined from 4.59% on September 30, 2007 to a low of 2.06 on December 30, 2008%.